In the United States Bankruptcy Court
for the
Southern District of Georgia
Savannah Division

In the matter of:	)	
	)	Adversary Proceeding
LAURA M. BUTLER	)	
(Chapter 13 Case 96-40658)	)	Number 96-4041
	)	
Debtor	)	
	)	
	)	
	)	
LAURA M. BUTLER	)	
	)	
Plaintiff	)	
	)	
	)	
v.	)	
	)	
THE UNITED STATES OF AMERICA	)	
AND THE UNITED STATES	)	
DEPARTMENT OF EDUCATION	)	
	)	
Defendant	)	

MEMORANDUM AND ORDER

Plaintiff, Laura M. Butler (hereinafter "Plaintiff"), brought this adversary proceeding against the United States of America, et.al., (hereinafter

"Defendant") to recover an alleged preferential transfer. Plaintiff also claims that Defendant wilfully has violated the automatic stay and requests attorney's fees and other appropriate relief. Defendant contends that its action were a permissible setoff pursuant to 11 U.S.C. Section 553. The matters involved herein constitute a core proceeding over which this Court has jurisdiction. *See* 28 U.S.C. § 157(b)(2)(F). After considering the evidence submitted, as well as the applicable authorities, I make the following Findings of Fact and Conclusions of Law pursuant to Bankruptcy Rule 7052.

FINDINGS OF FACT

The following facts are not in dispute. Plaintiff, Laura M. Butler, executed promissory notes to secure a Guaranteed Student Loan ("GSL") (currently termed a "Federal Family Education Loan Program" loan), authorized by Title IV, Part B of the Higher Education Act of 1965, as amended (20 U.S.C. § 51070 et seq.), totaling $2,625.00 from Florida Federal Savings and Loan ("FFSL"). The GSL was guaranteed by the Higher Education Assistance Foundation ("HEAF").

The terms of the promissory notes executed by Plaintiff required repayment beginning six months after she ceased to carry at least one-half of the normal full-time academic workload at an eligible institution. On or before May 31, 1989, Plaintiff ceased carrying at least one-half the normal full-time academic workload. On

April 4, 1991, Plaintiff defaulted on her repayment obligations. On or about December 31, 1991, FFSL assigned all rights and title to the loan to HEAF.

Under a contract for reinsurance between HEAF and Education, Education agreed to reimburse HEAF for its losses in making payments to lenders in the event of default, death, or disability. *See* 20 U.S.C. § 51078(c). On July 26, 1993, Education received assignment of the GSL pursuant to its right to take assignment of a defaulted GSL that its pays reinsurance claims. *See* 20 U.S.C. § 078(c)(8).

Since the assignment of the GSL, Plaintiff has failed to make any voluntary payments to satisfy her loan obligations. Thus, on March 11, 1996, Education, in cooperation with the IRS, setoff Plaintiff's 1995 tax refund, pursuant to Section 2653 of the Deficit Reduction Act of 1984, now codified at 31 U.S.C. § 3720A and 26 U.S.C. § 6402(d). *See* Bosarge v. United States Department of Education, 5 F.3d 1414, 1417-1418 (11th Cir.1993); In re Orlinski, 140 B.R. 600, 602 (Bankr.S.D.Ga. 1991) (recognizing tax offset authority).

Following the offset of Plaintiff's tax refund, Plaintiff filed a petition under Chapter 13 of the Bankruptcy Code on March 13, 1996. On or about March 15, 1996, Plaintiff filed a Complaint against the United States Department of Education

(Education) and Internal Revenue Service (IRS) seeking return of her 1995 tax refund under 11 U.S.C. Section 547.

Defendant, United States, contends that its actions were permissible pursuant to the setoff provisions of 11 U.S.C. Section 553. On June 10, 1996, Defendant filed a Motion for Summary Judgment which the Court denied on August 12, 1996. A trial was held on September 26, 1996, at which time Defendant again renewed its Motion for Judgment based on the pleadings and the applicable law. After reviewing the parties' post-trial briefs, the Court now grants judgment in favor of the Plaintiff.

CONCLUSIONS OF LAW

Section 553 preserves in bankruptcy a creditor's setoff rights that are available under other state or federal law. However, Section 553 does not create an independent right to setoff; to utilize Section 553, a creditor first must demonstrate that this right exists under other applicable law. After meeting this burden, a creditor must satisfy the additional requirements of Section 553. Only if those requirements are met will the setoff be permissible.

Here, it is undisputed that the IRS has the statutory authority to setoff. *See* 31 U.S.C. § 3720A(c) and 26 U.S.C. § 6402(d). *See* 31 U.S.C. § 3720A(c) and 26

U.S.C. § 6402(d); *see also* Bosarge v. United States Department of Education, 5 F.3d 1414, 1417-1418 (11th Cir.1993) ("[w]e hold that 26 U.S.C. § 6402(d) and 31 U.S.C. § 3720A establish 'statutory rights of setoff'"); In re Orlinski, 140 B.R. 600, 602 (Bankr.S.D.Ga. 1991) (recognizing tax offset authority). Thus, Defendant must only meet the requirements of 11 U.S.C. Section 553 to prevail on its Motion.

11 U.S.C. Section 553, in pertinent part, provides as follows,

> (a) . . . this title does not affect any right of a creditor to offset a mutual debt owing by such creditor to the debtor that arose before the commencement of the case under this title against a claim of such creditor against the debtor that arose before the commencement of the case, except to the extent that . . .
>
> (1) the claim of such creditor against the debtor is disallowed;
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> (2) such claim was transferred, by an entity other than the debtor, to such creditor--
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> (A) after the commencement of the case; or
>
> (B)(i) after 90 days before the date of the filing of the petition; and
>
> (ii) while the debtor was insolvent; or
>
> (3) the debt owed to the debtor by such creditor was incurred by such creditor--
>
> (A) after 90 days before the filing of the petition
>
> (B) while the debtor was insolvent; and

> (C) for the purpose of obtaining a right of setoff against the debtor.
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> (b)(1) . . . if a creditor offsets a mutual debt owing to the debtor against a claim against the debtor on or within 90 days before the date of the filing of the petition, then the trustee may recover from such creditor the amount so offset to the extent that any insufficiency on the date of such setoff is less than the insufficiency on the later of--
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> (A) 90 days before the date of the filing of the petition; and
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> (B) the first date during the 90 days immediately preceding the date of the filing of the petition on which there is an insufficiency.
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> (2) . . . "insufficiency" means amount, if any, by which a claim against the debtor exceeds a mutual debt owing to the debtor by the holder of such claim.

1. Whether The Debts Are Mutual

The parties contest this first issue. Defendant, United States, contends that mutuality exists between a claim arising from a federal agency other than the IRS and a debtor's claim to a tax refund. In support of this position, Defendant cites In re Sound Emporium, 43 B.R. 1, 2-3 (Bankr.W.D.Tex. 1984) (finding that claim against contractor for unpaid federal taxes and a debt owed by the United States Army under a contract are mutual); U.S. v. Luther, 225 F.2d 495, 498 (10th Cir.1954) (finding that debts to Commodity Credit Corporation and a claim for an income tax refund are mutual). To the contrary, Plaintiff asserts that the obligations are not mutual. Plaintiff

contends that the each government agency is separate and distinct and should be treated as such. Moreover, Plaintiff notes that Section 553 setoff should be interpreted narrowly in light of Section 547. *See* In re Turner, 59 F.3d 1041, 1045 (10th Cir.1995) (holding that setoff between SBA and ASCS was impermissible); In re Ionosphere Clubs, Inc., 164 B.R. 839 (Bankr.S.D.N.Y. 1994) (holding that federal government units are to be treated as distinguishable for setoff purposes); In re Lakeside Community Hosp., Inc., 139 B.R. 886 (Bankr.N.D.Ill. 1992) (holding that state revenue and education agencies were separate entities for purposes of setoff); In re Howard, 1988 WL 96197 (Bankr.E.D.Pa.) (holding that no mutuality exits between debt owed to Dept of Education and IRS refund obligation).

Although both parties present persuasive arguments, the language of 31 U.S.C. Section 3720A(c) clearly contemplates permitting setoff between government agencies and treating the individual agencies as branches of one governmental unit. *See* 31 U.S.C. § 3720A(c) ("[i]f the Secretary of Treasury finds that any such amount is payable, he shall reduce such refunds by an amount equal to the amount of such debt, pay the amount to such agency, and notify such agency . . . "); *see also* Bosarge v. United States Department of Education, 5 F.3d at 1419 (holding that 3720A treats Federal agencies as if they were one agency); In re Reed, 179 B.R. 353, 354 (S.D.Ga. 1995) (holding that the government may setoff funds owed by one agency in order to collect

debts owed to other agencies). In light of the above, Defendant has satisfied the requirement of mutuality of debts.

II. Whether The Debts Arose Pre-Petition

There is no dispute over this requirement. Clearly, Plaintiff's obligation arose pre-petition. Plaintiff enrolled in less than a full academic workload on May 31, 1989 and commenced debt payments shortly thereafter. Plaintiff defaulted on her obligation on April 4, 1991; the debt was assigned to Education on July 26, 1993. In regard to the 1995 tax refund owed by the IRS, that obligation arose on one of three possible dates: December 31, 1995, the date Plaintiff filed her tax refund, or the date on which the IRS formally acknowledged pursuant to 26 U.S.C. Section 6407 that the taxpayer is owed a refund. Although there may be some debate as to which one of these dates constitutes the actual date on which a tax obligation accrues, there is no dispute that all three of these dates occurred pre-petition.

III. 553(a) Limitations

Section 553(a) contains three limitations to a creditor's right to setoff. First, under Section 553(a)(1), an existing right to setoff may not be exercised to the extent that the claim is disallowed. As far as this Court is aware, this provision is inapplicable to the current matter. Plaintiff defaulted on her loan obligation and the

Department of Education has a right to collect its loan in the full amount. Second, Section 553(a)(2) denies a creditor the right to setoff when the claim was transferred by an entity other than the debtor to a creditor after the debtor filed for relief under the Code or within the 90 days prior to filing. Here, there is no evidence of a transfer of this debt to the government during the ninety days prior to filing. Defendant has held this obligation for at least three years and has not assumed the debts of other creditors. Defendant has satisfied its burden pursuant to Section 553(a)(2). Finally, Section 553(a)(3) limits the right to setoff when a debt owed to the debtor was incurred by a creditor within ninety days prior to the filing of the petition for the purpose of exercising a right to setoff. This limitation is not applicable because the debt that the IRS owes although created within ninety days of filing was not incurred for the purposes of obtaining a right to setoff. Therefore, Defendant has met all three requirements of 553(a).

IV. Section 553(b)

Section 553(b) contains the final limitation on a creditor's right to setoff. This limitation, commonly referred to as the "Improvement in Position Test," expressly prevents any creditor from improving its position within the ninety days prior to bankruptcy. Essentially, Section 553(b) limits the exercise of pre-petition setoff. It examines the amount owed to a creditor ninety days prior to bankruptcy and on the date

of filing; any difference in the insufficiencies on the two dates amounts to a preference and an impermissible setoff. In the Motion for Summary Judgment, I held that the amount of the insufficiency ninety days prior to bankruptcy was $2,625.00 following the majority of case law which recognizes that an insufficiency may exist without debts and credits running in both directions. *See, e.g.* Matter of Lawndale Steel Co., 155 B.R. 990, 995 (Bankr.N.D.Ill. 1993); Hankerson v. United States Department of Education, 133 B.R. 711 (Bankr.E.D.Pa. 1991), *rev'd on other grounds*; In re Schmidt, 26 B.R. 89 (Bankr.D.Minn.1982); In re Keystone Foods, 145 B.R. 502, 507 (Bankr.W.D.Pa. 1992). Noting that the Defendant improved its position by off setting a tax refund of the Plaintiff which accrued during the preference period, I denied Defendant's Motion for Summary Judgment and set the matter for trial.

At trial, Defendant contested the legal conclusion that an insufficiency may exist without debts and credits running in both directions by relying on the plain language of the statute and requested that the Court reconsider its prior position. Defendant interprets the term "mutual debt" as requiring mutual debts and credits between the parties to be in existence before any insufficiency arises. Because in the present case, on December 13, 1995, ninety days prior to trial, Defendant did not owe Plaintiff a tax refund, Defendant asserts that a mutual debt was not in fact owed. By definition then, an insufficiency did not exist. According to Defendant, an insufficiency

first arose on December 31, 1995, when the Internal Revenue Service's obligation to the Plaintiff actually accrued.[1] At that time, the amount of the insufficiency equaled $182 ($2,625.00 - $2,443.00). Because on the date of filing, after the $2,443.00 offset on March 11, 1995, the amount of the insufficiency remained at $182 and, thus, pursuant to Section 553(b), the amount of the insufficiency remained unchanged at the time of filing, Defendant, United States, contends that it did not impermissibly improve its position within the ninety days prior to filing. Although Defendant's "plain meaning" interpretation is intriguing, after examining the statutory scheme I hold that at the very least the statute is ambiguous and will chose instead to rely on the majority position.[2] *See* Matter of Lawndale Steel Co., 155 B.R. at 995-96. Therefore, I hold that Defendant, United States, impermissibly improved its position within the ninety days prior to bankruptcy and as a result will be required to turnover the amount of Plaintiff's 1995 tax refund previously withheld.

Within its proposed findings of fact and conclusions of law, Defendant also renews contentions that were addressed previously in this Court's Order on Defendant's Motion for Summary Judgment. The first is that Congress intended for

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[1] As noted previously, the tax refund obligation accrued on one of three dates: (1) the last day of the taxable year, (2) the date the Plaintiff filed her tax return, or (3) the date the I.R.S. pursuant to 26 U.S.C. Section 6407 formally acknowledges an overpayment by the taxpayer. At this point in time, the majority of case law seems to hold that a tax refund accrues to an individual on the last day of the taxable year. *See* In re Thorvund-Statland, 158 B.R. 837 (Bankr.D.Idaho 1993); *but see* Hankerson v. U.S. Department of Education, 133 B.R. at 717, *rev'd on other grounds*; In re Glenn, 1996 WL 387656 (Bankr.E.D.Pa.). Because all three possible dates fall within the 90-day preference period, for purposes of this discussion only, this Court will adopt the majority position.

[2] This Court has not found and the Defendant has not cited one case in support of his position.

Section 553(b) to apply only in instances that involve an "ongoing relationship" between a creditor and debtor, such as a bank and a typical depositor. Defendant contends that because it is not the type of creditor who races to the courthouse steps Section 553(b) does not apply to it. However, as stated in the Order on Defendant's Motion for Summary Judgment the test is clearly an objective one. While Congress may have intended to address a concern that arises primarily in "ongoing relationships," nowhere in Section 553(b) does Congress require a court to determine the intent of the parties or their ability to demand payment. Moreover, considering the purpose of the statute, Congress enacted Section 553(b) to prevent creditors from improving their position and forcing an individual into bankruptcy. Clearly, Defendant is the kind of creditor whose actions can have the effect of forcing an individual into bankruptcy, reducing their chance for an effective reorganization and limiting the recovery for all creditors. In this case, Plaintiff filed for bankruptcy only two days after the IRS set off her tax refund.

Defendant suggests that in cases with "facts identical to this case" courts have held that the offset was permissible. *See* Matter of Moses, 91 B.R. 994, 997 (Bankr.M.D.Fla. 1988). However, as explained in the Order on Defendant's Motion for Summary Judgment, the facts in those cases are not identical because in Moses, although the setoff occurred within 90 days of bankruptcy, there was no change in the insufficiency within 90 days of filing.[3]

[3] Within its proposed findings of fact and conclusions of law, Defendant also asserts that Plaintiff's claim to her tax refund arose prior to the end of the taxable year and cites Lee v. Schweiker, 739 F.2d 877 (3rd Cir.1984), for the proposition that because this claim arose outside of the preference period the amount of the insufficiency

Defendant also asserts that the relevant offset provisions, 31 U.S.C. Section 3720A and 26 U.S.C. Section 6202(d), create an unavoidable statutory lien. This Court has reviewed the language of both provisions and is unpersuaded by this contention. The statutes provide the manner in which an agency shall exercise a setoff and is silent regarding statutory liens. Without an express provision granting a lien in favor of the Defendant, this Court is not inclined to imply such a lien.

Finally, Defendant claims that its statutory right of setoff entitles it to receive treatment as a secured creditor and, therefore, retain the amount setoff as adequate protection. Defendant cites Lee v. Schweiker, 739 F.2d at 873; however, that discussion only summarized the holding of the bankruptcy court. Later, in a footnote, the Third Circuit Court of Appeals when reviewing the lower court's granting of secured status to post-petition payments already received stated,

> The Bankruptcy Court's analysis of this issue is fundamentally flawed because it does not take into account of this limitation on setoff. The court held that SSA had a "statutory right of setoff." This right, however, is limited by section 553. Since section 506 only creates "secured creditor" status for creditors with rights of setoff under Section 553, and the right of SSA to

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remained unchanged during the preference period. However, the Third Circuit Court of Appeals in Lee only determined that pursuant to Section 553(b) a claim arises on the day it accrues and not on the day it becomes payable. *See* Id. at 877 (holding that monthly SSA benefits have accrued "for the purposes of applying the 'improvement in position' test, even though they are not yet payable"). Thus, in accordance with Lee a tax refund claim arises on the last day of each taxable year instead of on either the date the Plaintiff filed the tax return or the date the I.R.S., pursuant to 26 U.S.C. Section 6407, formally acknowledges an overpayment by a taxpayer to determine when a claim arises. Because this date is still within the preference period, Defendant's assertion has no merit.

> set off the over-payment against post-petition benefits runs afoul of a limitation of setoff contained in that section, SSA was not entitled to "secured status" as to the amount of the overpayment . . . .

Id. at 875, n.7. Following the reasoning of the Court in Lee, because Defendant, United States' right of set off is limited by the Section 553 exception, I hold that it may not retain the amount withheld as a form of adequate protection.

Accordingly, because the Internal Revenue Service acting pursuant its statutory authority to setoff has not met the additional requirements of 11 U.S.C. Section 553(b) its setoff was impermissible and judgment shall be granted in Plaintiff's favor.

Plaintiff also has requested attorney's fees for a violation of 11 U.S.C. Section 362. Because Defendant's setoff occurred prior to Debtor's filing and because any post-petition refusal to turnover property of the estate was committed pursuant to Defendant's rights under Citizens Bank v. Strumpf, --- U.S. ---, ---, 116 S.Ct. 286, 133 L.Ed. 2d 258 (1995) (holding that bank's post-petition administrative freeze until Court determined right to set off was permissible and not a violation of the automatic stay), no Section 362 violation occurred in this case and, therefore, no attorney's fees will be awarded.

O R D E R

Pursuant to the foregoing Findings of Fact and Conclusions of Law, IT IS THE ORDER OF THIS COURT that Judgment is granted in favor of Plaintiff, Laura M. Butler. Defendant, United States of America, is hereby ordered to remit $2,443.00 to the Chapter 13 Trustee.

IT IS FURTHER THE ORDER OF THIS COURT that the request of attorney's fees sought by the Plaintiff is hereby DENIED.

Lamar W. Davis, Jr.
United States Bankruptcy Judge

Dated at Savannah, Georgia

This ____ day of January, 1997.